Supreme Court, U.S.
FILED
061089 JAN 29 2007
OFFICE OF THE CLERK

No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

James J. Hayes

Petitioner,

vs.

DENVER AREA MEAT CUTTERS AND EMPLOYERS PENSION PLAN

Respondent,

vs.

JAMES L. CLAYTON, et al.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF TENNESSEE AT KNOXVILLE

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether Tennessee courts denied class members their Fourteenth Amendment rights to due process and/or equal protection in approving a class action settlement:

a) without making findings based on the record that the "settlement class" met the requirements of Rule 23(a) and (b), as required by Federal Circuit courts;

b) that released the defendants from potential federal and state claims that were not included in the complaint and were not adequately represented by the plaintiff ;

c) without making findings on the "likelihood of success" in a trial or "potential recovery" if the class succeeded on their breach of fiduciary claims as required by federal law in similar class action settlements;

d) that re-phrased the appellate question in a manner that trivialized question, leaving undecided the substantive issues presented by the question as written;

e) by acting as a trial court and deciding erroneously that the "likelihood of success" at trial was zero when the trial court had not made any findings on the "likelihood of success;"

f) by disregarding Tennessee Supreme Court authority finding federal authority "persuasive" when the applicable federal and state rules are identical, and in addressing post trial allegations of corruption; and

g) by disregarding its prior holdings remanding a class action for an additional fairness hearing to consider "the range of possible outcomes and probability of each" while denying this class the same protection.

PARTIES TO THE PROCEEDINGS

Petitioner James J. Hayes is an absent member of the "settlement class" of former shareholders of Clayton Homes, Inc. who were deprived of their ownership at an inadequate price by the cash-out merger with Berkshire Hathaway.

Respondent Denver Area Meat Cutters and Employers Pension Plan is the representative plaintiff of the "settlement class" and an appellee below.

Respondents James L. Clayton, Kevin T. Clayton, C. Warren Neel, B. Joe Clayton, Steven G. Davis, Dan W. Evins, Wilma H. Jordan and Thomas N. McAdams were directors of Clayton Homes during the merger and defendants/appellees below.

TABLE OF CONTENTS

QUESTION PRESENTED i

PARTIES TO THE PROCEEDINGS ii

INTRODUCTION 1

OPINIONS BELOW 1

JURISDICTION 2

CONSTITUTIONAL PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE PETITION 7

A. A Variety Of Clear Cut Fourteenth Amendment Issues Offer This Court The Opportunity To Insure That Members Of State Class Actions Benefit From Federal Jurisprudence That Protects Class Members From Abusive Class Action Settlements 10

1. The Fourteenth Amendment Insures That State Courts Follow The Same Procedures In Certifying Settlement Classes That Are Required By Federal Courts 11

2. The Fourteenth Amendment Insures That State Courts Not Approve Class Action Settlements That Release Claims Not Evaluated By The Court 12

3. The Fourteenth Amendment Insures That State Courts Apply The Same Sound Economic Analysis Uniformly Required By Federal Courts In Evaluating Federal Class Action Settlements 14

B. A Variety Of Arbitrary Rulings By The State Court Of Appeals Offers This Court The Opportunity To Insure That Members Of State Class Actions Are Protected By The Fourteenth Amendment 16

TABLE OF CONTENTS – CONTINUED

1. The Fourteenth Amendment Requires State Courts of Appeal To Consider The Issues Actually Raised By The Appellants In Deciding Appeals 17

2. The Fourteenth Amendment Requires State Courts Of Appeal To Not Act As Trial Courts By Deciding Facts Properly Decided By The Trial Court On Remand 19

3. The Fourteenth Amendment Requires State Courts Of Appeal To Follow Their State's Supreme Court Opinions . 21

   a. Disregarding Federal Authority..... 21

   b. Not Relinquishing Jurisdiction 23

4. The Fourteenth Amendment Requires State Courts of Appeal To Follow Their Own Precedent..... 25

C. Granting This Petition And Finding That The Fourteenth Amendment Applies To State Class Actions Is A Necessary Link Applying The Federal Constitution To Going Private Transactions Under The Aegis Of State Merger Law..... 27

CONCLUSION 30

APPENDICES:

A. Court Of Appeals Of Tennessee Opinion A1

B. Trial Court Memorandum A21

C. Supreme Court Of Tennessee Order.....A23

D. Excerpts From Tennessee And Federal Rule 23 .....A24

E. Ben Stein Article – *On Buyouts, There Ought To Be A Law* A25

TABLE OF AUTHORITIES

Cases:

Bayberry Associates v. Jones, 783 S.W. 2d 553 (Tenn. 1990) 22

Bennett v. Behring Corp., 737 F 2d. 982 (11th Cir. 1984) 14

Bowman v. Henard, 547 S.W. 2d 527 (Tenn. 1977)..... 22

Dartmouth College v. Woodward, 17 U.S. (4 Wheat) 518 (1819)..... n13,p.28

Denver Area Meat Cutters v. Clayton, 120 S.W. 3d 841 (Tenn. Ct. App. 2003) 2,4,5

In Re General Motors Corp. Pick-Up Truck Fuel Tank, 55 3d. 768 (3d Cir. 1995)..... 8,11,15

International Union of Electronic, Electrical, Salaried, Mach, and Furniture Workers, AFL-CIO v. Unisys Corp., 155 F.R.D. 41 (E.D.N.Y. 1994)..... 13

Kahn v. Lynch Communications Systems Inc., 638 A. 2d 1110 (Del. 1994)..... 13,30

Knox County v. Burroughs, 369 S.W. 2d 734 (Tenn. 1963)..... 20

In re Medtronic, Inc., Implantable Defibrillator Product Liability Litigation, Case 0:05-md-01726-JMR-AJB (D. Minn.) ... n.11,p.24,25

Meighan v. U.S. Sprint Comm. 924, S.W. 2d 632 (Tenn. 1996) 22

Missouri ex. rel. Missouri Ins. Co. v. Gehner, 281 U.S. 313 (1930) .. 3

Moore, et al., v. Halliburton Company, et al., 7 WL2092019, (N. D. Texas 2004)..... 13

Peck v. Tanner, 181 S. W. 3d 262 (Tenn. 2005)..... 20,23,25

Pigford v. Johanns, 416 F. 3d 12, (D.C. Cir. 2005)..... 25

TABLE OF AUTHORITIES – CONTINUED

Posey et al. v. Dryvit Systems et al., No E2004-02013-COA-R9-CV (Tenn. Ct. App. 2005) 25,26,27

Reynolds v. Beneficial Nat. Bank, 288 F. 3d. 277 (7th Cir. 2002) 8,15,26

Spence v. Allstate Ins. Co. 883 S.W. 2d 586 (Tenn. 1994) 23,25

Stewart v. General Motors, 756 F. 2d 1285, (7th Cir. 1985) 24

In re Wireless Telephone Federal Cost Recovery Fees Litigation, 396 F. 3d 922 (8th Cir. 2005) 24

Wood v. Georgia, 450 U.S. 261 (1981) 3

Constitution:

Article 1 section 10 ..... n.12,p.28

Fourteenth Amendment ..... passim

Statutes:

15 U.S.C. 78u-4 (1995) 15

Other Authority:

Fed. Rs. Civ P. 23 8,11,12,21

Tenn. Rs. Civ P. 23 21,22

Tenn. Rs. Civ. P. 60 23,25

Newspaper Articles:

On Buyouts, There Ought to Be a Law, NY Times, Sept. 3, 2006 Bu p. 3 ..... n.13,p.29, App.E, p.25

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PETITION FOR WRIT OF CERTIORARI

James J. Hayes, a member of the Settlement Class of former shareholders of Clayton Homes, who lost their ownership of Clayton in a merger, respectfully requests that this Court grant this petition for a writ of certiorari to review the judgment of the Tennessee Court of Appeals at Knoxville.

OPINIONS BELOW

The unpublished Opinion of the Court of Appeals affirming the Blount County Circuit Court's approval of

the Settlement appears in Appendix A at page A1. (App. A, A1) The Trial Court Memorandum approving the Settlement appears Appendix B at page A21.

A related opinion – *Denver Area Meat Cutters v. Clayton*, 120 S.W. 3d 841 (Tenn. Ct. App. 2003) – was a significant factor in the Court of Appeals decision to affirm settlement approval. That opinion denied the plaintiff's standing to pursue derivative claims based on director breach of fiduciary duty. The Court of Appeals expressed concerns that class claims in the complaint might be disguised derivative claims. It instructed the Circuit Court to sort through the claims, certifying those "with injuries done to the plaintiff" as class claims. *Id. 859* However, the Circuit Court had not certified the claims before approving the settlement. This created a dilemma for the Court of Appeals when considering the appeal. In affirming the settlement, the Court of Appeals apparently assumed that the class claims were really derivative claims in disguise.

JURISDICTION

The Opinion of the Court of Appeals was entered on May 9, 2006. (App. A, A1) The application for permission to appeal to the Tennessee Supreme Court was denied on October 30, 2006. (App. C, A23) The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).

CONSTITUTIONAL PROVISIONS INVOLVED

The Equal Protection and Due Process Clauses of the of the Fourteenth Amendment, which in pertinent part reads:

> No State shall...deny to any person within its jurisdiction the equal protection of the laws,

....nor shall any State deprive any person of life, liberty, or property, without due process of law....

Amendment XIV, Section 1 (1868)

The Fourteenth Amendment issues were not raised below, however, the case falls within this Court's exceptions to the principle that questions considered for review benefit from argument below. The questions on due process fall squarely within *Wood v. Georgia*:

> Where, as here, a possible due process violation is apparent on the particular facts of a case, we are empowered to consider the due process issue.

Wood v. Georgia, 450 U.S. 261, 265 (1981)

The failure of the Court of Appeals to provide class members equal protection by disregarding its own, Tennessee Supreme Court, and Federal Circuit Court authority in evaluating similar class action settlements could not have been anticipated. Under these circumstances, this Court has waived raising the Constitutional issues below.

> A judgment of a state court so construing a state statute as to cause it to infringe federal rights is reviewable in this Court... if the construction was one that the party affected could not have anticipated....

Missouri ex. rel. Missouri Ins. Co. v. Gehner, 281 U.S. 313 (1930)

STATEMENT OF THE CASE

This case is an appeal of the approval of a premature settlement of a Tennessee class action law suit following

the cash out merger of Clayton Homes by Berkshire Hathaway. The class claims for breach of fiduciary duty against members of Clayton's Board of Directors were a hasty addition[1] to a derivative action that sought a temporary restraining order to prevent consummation of the merger after the merger was narrowly approved by shareholders.

On August 7, 2003, following extensive litigation on the restraining order, the Tennessee Court of Appeals ruled that the plaintiff had not shown any evidence of fraud in the shareholder vote, and there was no legal or factual basis to unwind the merger. The court remanded the class claims to the trial court for an orderly review:

> The trial court decreed that the plaintiff's class action should proceed below. We agree. A class has not been certified in the *Blosser* Delaware litigation. That case appears to be the only litigation other than the instant case in which class certification is being sought arising out of the subject merger. We see no reason to stay the instant class action litigation at this time, particularly in view of the fact that the parties have represented to us that *Blosser* is attempting to be dismissed from the Delaware litigation while the defendants there have taken the unusual step of asking the Vice Chancellor to certify the class.
>
> *Denver Area Meat Cutters v. Clayton*, 120 S.W. 3d 841, 859 (Tenn. Ct. App. 2003)

The Court of Appeals further instructed the trial court to identify the claims that related to the "injuries done to the plaintiff and such class members as may be certified... in an

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[1] The class claims were added on July 30, 2003, the same day as the postponed vote on the merger.

orderly manner consistent with the nature of this class action suit." *Id. 860.* However, the plaintiff delayed amending the complaint, and the defendants finally filed a motion to dismiss on October 24, 2003. This prompted plaintiff's motion to amend the complaint on December 1, 2003.

Surprisingly, the amended complaint did not include any new claims but simply deleted the failed derivative claims that apparently relied on common state law fraud statutes.[2]

In addition, the plaintiff did not move to certify the class as ordered by the Court of Appeals. Rather, the parties began settlement discussions which according to the parties began

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[2] Federal and state fraud differ with respect to their focus and application. Federal rules strictly regulate the information proxies can provide shareholders on voting their shares. All proxy material, written and oral, must be reviewed and cleared by the Securities and Exchange Commission ("SEC"). Consequently, it is unlawful for anyone to solicit shareholder votes using information that has not been cleared by the SEC. Clayton's postponement of the merger vote because management was not successful in obtaining a majority vote in favor of the merger at the shareholders meeting, and their later success in getting key institutional shareholders to change their vote to favor the merger provides fertile grounds for proxy fraud claims.

The Clayton merger provided numerous circumstances for federal proxy fraud violations that wouldn't violate state law. For example, the plaintiff's fraud investigation revealed that Clayton directors had personally solicited key institutional shareholders who had not voted for the merger, but who had sold their stock before the vote was tallied. Thus, these shareholders had little or no reason to change their votes to favor the merger. (See Denver at 858.) While the Court of Appeals found no evidence that this solicitation violated the generalized state fraud statutes, the very fact that institutions – who had no reason to change their vote – changed their vote is evidence that Clayton procured this vote with some inducement or threat which would violate Federal proxy rules. Thus the Court of Appeals opinion could have reached the opposite conclusion if it were making its decision on the basis of federal proxy rules rather than the more generalized state fraud statutes.

shortly after December 1, 2003. The discussions, which according to the parties, were "protracted and contentious," concluded successfully and the Stipulation of Settlement was filed with the circuit court in Maryville, Tennessee on March 17, 2005.

In exchange for a release by the "Settlement Class" of its claims against them, the Defendants agreed to pay $5 million in cash and a contingent consideration if Berkshire Hathaway sold Clayton Homes for more than an adjusted $1.7 billion prior to December 31, 2005. Plaintiff's counsel estimated the cash payment at 10.5 cents per share of Clayton stock.

On March 18, 2005, the court in Maryville preliminarily certified the "Settlement Class," and the fairness of Settlement so that class members could be notified of the Settlement, and the Settlement Hearing that was held on May 16, 2005. Six class members filed written objections, three of whom argued their objections at the hearing.

On May 19, 2005, the Maryville court issued a perfunctory one page Memorandum that gave its final approval of the Settlement. (App. B, A21) The court found the settlement fair, reasonable, adequate and in the best interest of the class and each of its members. The court reported its findings were based on the hearing arguments, plaintiff's motions and a review of the "entire record" in the case.[3] Notably the court did not consider a damage estimate as the plaintiff's had not retained a damage expert.

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[3] The nearly exclusive focus in both the record and plaintiff's self-serving submissions was how the failure of the derivative claims to stop or undue the merger had destroyed the prospects for success of the class claims. However, because courts require higher legal and factual

Cont.

The petitioner appealed the settlement approval and raised the following questions with the Court of Appeals:

A. Can a court find a settlement is fair without considering the potential damages that could be recovered had the case proceeded to trial?

B. Can a court find a settlement is fair to the class and individual members that nets a *de minimis* per share recovery for the class while it guarantees a substantial fee to class counsel?

C. Can a court approve a settlement in a case where the complaint omits claims that could provide substantial relief but would be extinguished in the settlement?

On May 9, 2006, the Court of Appeals affirmed the judgment of the Trial Court approving the settlement.

REASONS FOR GRANTING THE PETITION

Granting this petition provides this Court the opportunity to provide Fourteenth Amendment protection to large numbers of people in class actions who are abused by State courts thorough arbitrary rulings that ignore: a) State and Federal law in approving class action settlements that provide little or no value to class members, and b) the Federal constitution which protects shareholders subjected to management and insider led going private transactions

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standards to unwind a merger, for example, the failure of the derivative claims had little relevance to the likelihood the class could win substantial damages even considering the similarity of substantive allegations underlying both claims. In any event, the plaintiff did not present any independent expert analysis to support its self-serving legal analysis.

from private party abuse of State merger law to break the shareholder contract without adequate compensation.

Federal courts are increasingly aware of the potential abuse faced by absent members in class actions. The problem was succinctly stated by Judge Posner:

> The principal issue presented in these appeals is whether the district judge discharged the judicial duty to protect the members of a class in class action litigation from lawyers for the class who may, in derogation of their professional and fiduciary obligations, place their pecuniary self-interest ahead that of the class. This problem, repeatedly remarked by judges and scholars, [cites omitted] requires district judges to exercise the highest degree of vigilance in scrutinizing proposed settlements of class actions.
>
> *Reynolds v. Beneficial Nat. Bank*, 288 F. 3d. 277, 279 (7th Cir. 2002)

Judge Posner's conclusion that district courts had a fiduciary duty to examine the substantive provisions of class action settlements follows an earlier pioneer Federal circuit opinion that required district courts to make findings "based on the record" that the requirements of Rule 23 (a) and (b) are met before certifying "settlement classes" rather than basing these findings on a affidavit or order prepared by class counsel. Judge Becker reached these conclusions after observing:

> [t]hat the [settlement class] is a vehicle for collusive settlements that primarily serve the interests of the defendants – by granting expansive protection from law suits – and of plaintiffs' counsel – by generating

large fees gladly paid by defendants as a quid pro quo for finally disposing of many troublesome claims.

In Re General Motors Corp. Pick-Up Truck Fuel Tank, 55 3d. 768, 778 (3d Cir. 1995)

Congress also recognized abuse in securities class actions. In 1995, Congress passed the Private Litigation Securities Reform Litigation Act. ("PSLRA") Although focused on other reforms, this legislation established timelines for class notification and certification which precludes the use of "settlement classes" in securities class actions.

Finally, there are currently many concerns being raised in the financial press about the fairness of the price paid to the acquired firm's public shareholders from management and insider led going private transactions. A recent article posted on the *Miami Herald.com* reported that private equity firms spent a record of $725 billion cash to take public companies private in management led transactions in 2006.[4] Another recent article in *The New Yorker* reported that a "study of buyouts over the past two years suggests that when management is the buyer it pays, on average, thirty per cent less than an outside bidder."[5]

If representative, the statistics cited in the *New Yorker* and *Miami Herald* articles suggest that public shareholders were coerced (by abuse of State merger laws) to transfer $218 billion dollars to private buyout funds in 2006. Questions on the prices paid and the procedures used to effect management

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[4] Joe Bel Bruno, *Stock market fueled record pace of mergers and acquisitions*, The Miami Herald.com, Dec. 31, 2006.

[5] James Surowiecki, *Private Lies*, The New Yorker, Aug.28, 2006.

and insider led buyouts raise questions whether shareholders are receiving equal protection under the Fourteenth Amendment; the application of which could be decided by granting this petition.

A. A Variety Of Clear Cut Fourteenth Amendment Issues Offer This Court The Opportunity To Insure That Members Of State Class Actions Benefit From Federal Jurisprudence That Protects Class Members From Abusive Class Action Settlements

Granting this petition could insure that class members in State class actions are protected by the Due Process Clause of the Fourteenth Amendment that provides, at a minimum, that class members under State court jurisdiction enjoy the full panoply of procedural rights as members of Federal class actions. The Equal Protection Clause requires State courts provide class members the same protection as Federal law in certifying a class and approving settlements.

Original intent on the specific rights that the Fourteenth Amendment protects are those that the authors/drafters included in the 1866 Civil Rights Act, which preceded and spurred enactment of the Fourteenth Amendment. The protected rights included the right:

> [t]o make and enforce contracts, to sue, be parties, and give evidence, to inherit, purchase, lease, sell, hold, and convey real and personal property, and to full and equal benefit of all laws and proceedings for the security of persons and property.
>
> Civil Rights Act of 1866

The procedures followed by Tennessee courts in

certifying the Settlement Class and approving the fairness of the Settlement to individual class members in the forced merger sale of their stock in Clayton Homes to Berkshire Hathaway clearly falls within the property rights that the drafters of the Fourteenth Amendment intended to protect. The fact, as explained below, that the procedures followed by the Tennessee courts did not provide the class procedural due process and equal protection of the laws justifies granting this petition.

1. The Fourteenth Amendment Insures That State Courts Follow The Same Procedures In Certifying Settlement Classes That Are Required By Federal Courts

The Trial Court's only effort in certifying the settlement class was signing a proposed order prepared by class counsel. The court did not make Rule 23 findings based on the record that the representative plaintiff's claims were typical of the claims of the class, for example, or that the representative parties fairly and adequately protected the interests of the class.[6] Such one-sided certification procedures precludes absent class members from introducing additional claims and different sets of common facts; with the class then benefiting from having the certification decision based on a full hearing of all the facts and claims.

Since 1995 Federal courts have not permitted the use of "settlement classes:"

> unless the record establishes, by findings of the district judge, that the same requisites of the Rule

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[6] In this case, the complaint was notably narrow as it excluded claims of a) proxy fraud and b) that the Clayton transaction was subject to Delaware's entire fairness doctrine because Berkshire Hathaway's agreement to acquire the Clayton family's stock made it a "dominant" shareholder.

[23] are satisfied. Additionally, we hold that a finding that the settlement was fair and reasonable does not serve as a surrogate for the class findings, and also that there is no lower standard for the certification of settlement classes than there is for litigation classes.

In Re General Motors Corp. Pick-Up Truck Fuel Tank, 55 3d. 768, 778 (3d Cir. 1995)

Granting this petition, offers this Court the opportunity to determine whether the Due Process and Equal Protection Clauses of the Fourteenth Amendment requires State courts to follow the same procedures for certifying State class actions that are required in Federal class actions.

2. The Fourteenth Amendment Insures That State Courts Not Approve Class Action Settlements That Release Claims Not Evaluated by the Court

The third issue in petitioner's State court appeal is whether a court could approve a class action settlement "where the complaint omits claims that could provide substantial relief but would be extinguished in the settlement." Petitioner argued in the Court of Appeals that the settled complaint had omitted proxy fraud claims and claims arising from Delaware's entire fairness doctrine as examples of claims that would be extinguished by the release provisions of the Settlement.

The petitioner cited the following Federal district court authority to support the thesis that class action settlements can not release claims beyond those evaluated by the court in considering the fairness of the settlement.

'[A] federal district court may not approve a

class-action settlement that seeks to release claims that are inadequately represented by the named plaintiffs.' *International Union of Electronic, Electrical, Salaried, Mach, and Furniture Workers, AFL-CIO v. Unisys Corp.*, 155 F.R.D. 41 48 (E.D.N.Y. 1994). In this case, the Release would extinguish claims that have not even been alleged and that do not relate to the claims in the suit. There is no basis for this Court to determine that the Lead Plaintiffs and Lead Counsel are adequate representatives for claims that have not been alleged. Again, the failure of Lead Counsel to resist an expected effort by Halliburton and the other Defendants to obtain a release of all conceivable claims arising during the class period naturally causes the Court to question the vigor of Lead Counsel's settlement advocacy.

Moore, et al., v. Halliburton Company, et al., 7 WL2092019, (N. D. Texas 2004)

In upholding settlement approval, the Court of Appeals ignored the petitioner's thesis and ruled narrowly that it simply "did not agree that Delaware's entire fairness doctrine is applicable in this case."[7] (App. A, A 18) The court would not consider the hypothetical release of proxy fraud claims because the petitioner had waived consideration by not

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[7] Petitioner argues, infra at 27, that Delaware's entire fairness exception to appraisal is too narrow and that the Fourteenth Amendment requires that the doctrine be extended to all management supported going private transactions.

Petitioner stated at the fairness hearing that he believed that Berkshire Hathaway was a dominant shareholder by virtue of its agreement to purchase the Clayton family's 28% voting interest in Clayton Homes.

Cont.

raising this example to the trial court.

The Court of Appeals analysis is simply not relevant to the question of whether courts can approve a settlement with a broad settlement release that would "extinguish claims that have not even been alleged and that do not relate to the claims in the suit," as explained by the district court in *Moore* at 13. The fact that the petitioner can cite two cogent claims omitted from the settled complaint is powerful argument that settlement releases should be narrowly drawn to include only the settled claims.

Granting this petition, offers this Court the opportunity to determine whether the Due Process and Equal Protection Clauses of the Fourteenth Amendment requires State courts to follow emerging Federal law that precludes approval of class action settlements with releases that extinguish claims other than those contained in the complaint.

3. The Fourteenth Amendment Insures That State Courts Apply The Same Sound Economic Analysis Uniformly Required By Federal Courts In Evaluating Federal Class Action Settlements

Federal Circuit courts uniformly require that district courts evaluating the fairness of class action settlements base their decisions on a sound economic analysis. The Eleventh Circuit requires, for example, that the economic analysis include a determination of 1) the likelihood of success at trial

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Control of this vote constituted 56% of the votes needed to approve the merger. Whether the purchase agreement made Berkshire Hathaway a "dominant" shareholder is a question that is properly addressed by a trial court when considering a thoroughly briefed motion to dismiss not in a "back of the envelope" analysis by the Court of Appeals.

and 2) the range of possible recovery. *Bennett v. Behring Corp.*, 737 F 2d. 982, 986 (11th Cir. 1984).

Circuit Judge Richard Posner, who perhaps is the singular authority on the Federal judiciary on economic analysis, further described the economic analysis required before courts can determine whether a class action is fair to class members.

> [T]he judge should have made a greater effort (he made none) to quantify the net expected value of continued litigation to the class, since a settlement for less than that value would not be adequate. Determining that value would require estimating the range of possible outcomes and ascribing a probability to each point on the range, (citing [Judge Becker's opinion] *In Re General Motors Corp. Pick-Up Truck Fuel Tank*, 55 3d. 768, 806 (3rd Cir. 1995) (([W]e agree that 'in cases primarily seeking monetary relief, the present value of the damages plaintiffs would likely recover if successful, appropriately discounted for the risk of not prevailing, should be compared with the amount of the proposed settlement.' (quoting MCL 2d at 30.44 p. 252))
>
> *Reynolds v. Beneficial Nat. Bank*, 288 F. 3d. 277, 284 (7th Cir. 2002)

Congress also determined that an estimate of the potential recovery from a trial is important information to class members evaluating the fairness of a proposed settlement. Consequently, the PSLRA, 15 U.S.C. 78u-4(a)(7), requires that the notification include a statement on damages on a per share basis.

Granting this petition, offers this Court the opportunity

to determine whether the Due Process and Equal Protection Clauses require State courts evaluating the fairness of class action settlements to base their opinions on sound economic analysis, including a determination of potential damages discounted by the risk of not prevailing, which federal courts require in the evaluation of Federal class actions.

B. A Variety Of Arbitrary Rulings By The State Court Of Appeals Offers This Court An Opportunity To Insure That Members Of State Class Actions Are Protected By The Fourteenth Amendment

The Court of Appeals made several arbitrary rulings in affirming the Trial Court's approval of the Clayton settlement that merit protection of the Fourteenth Amendment. (Issues d thru g under the Question.) Because the merger underlying the class claims required breaking the shareholder contract; the application of the Fourteenth Amendment falls within original scope of the Amendment. (See discussion on 10.)

Discriminatory State court rulings in class actions like Clayton is similar to the problem faced by former slaves and their abolitionist supporters that led to adoption of the Fourteenth Amendment. In this case, class members are losing their property, ownership of the corporate enterprise, in a merger a large majority did not vote to approve. In exchange for releasing all known and unknown claims the Court of Appeals has affirmed a settlement estimated at about ten cents per share or less than one per cent of the transaction price.

The Settlement Class, victimized by the failure of its representative to timely certify the class, is then confronted with an abusive settlement in courts in founder's home town. The Clayton family is among the most wealthy and politically powerful citizens in a state where the Court of

Appeals judges are elected.

This class action, more so than others, presents compelling circumstances in which the Court of Appeals favored the home town director defendants against a class dominated by national and international members. The situation is ripe for discriminatory rulings which favor the local political powers that the drafters of Fourteenth Amendment intended to prevent. The following discussion of the arbitrary Court of Appeals rulings that individually, and collectively are reasons for granting the petition.

1. The Fourteenth Amendment Requires State Courts of Appeal To Consider The Issues Actually Raised By The Appellant In Deciding Appeals

The second question before the Court of Appeals is:

> [c]an a court find a settlement is fair to the class and individual members that nets a *de minimis* per share recovery for the class while it guarantees a substantial fee to class counsel?

Statement of Issues, Brief of Appellant.

The question as stated presents a common and recurring problem in class action jurisprudence – whether class counsel is negotiating a settlement for his benefit or for the class's benefit. Settlement negotiations based on establishing a common fund where the parties negotiate the size of the fund rather than a per share amount based on damages suggests the former.

In bargaining for the common fund, counsel is really negotiating his fee – which by precedent established in large part by advocacy of the class action bar is a predictable share

of the settlement fund. Consideration of the amount paid to individual class members is an afterthought at best. [8]

Securities class action reforms in the PSLRA require that Federal securities class action settlement notices include per share estimates of the settlement's value. When presented in share terms, it is all too obvious that the payment to an individual class member with average holdings is too small to justify the cost of documenting and filing a claim. Consequently, many settlements provide no benefit for the average class member.

The intended question for the Court of Appeals is whether settlement funds that pay a *de minimis* per share amount to shareholders while at the same time "guaranteeing" substantial fees to counsel are abusive and should be rejected by courts charged by law with evaluating the fairness of the settlement to individual class members.

The Court of Appeals, however, read the question as:

> whether the trial court abused its discretion in approving the settlement despite the disparity between the attorney's fee allowed Denver's counsel and the amount of the per share recovery to Clayton shareholders under the settlement.
>
> *Opinion* (App. A, A13)

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[8] Counsel interested in putting the class in the strongest negotiating position would negotiate on a per share basis as this would focus the negotiations on the damages. This would be even more appropriate for merger offers which are always formulated on a per share basis. Class counsel would be better negotiators by buttressing negotiations with a fundamentally sound damage analysis and insisting that the settlement be closely related to these damages. In this case, Class counsel never determined the amount of damages and their negotiations necessarily focused solely on obtaining a common fund sufficiently large to pay them a satisfactory fee.

Clearly, the Court of Appeals introduced a trivialized version of the question that it easily disposed of. The court, however, avoided the question raised by the appellant of whether class action settlements that provide substantial benefits for class counsel while providing little or no benefit for class members are inherently abusive of the class.

Granting this petition will permit this Court to determine whether the due process and equal protection provided in the Fourteenth Amendment protects class members from State courts that permit abusive treatment of class members by simply "looking the other way" while approving settlements that pay class attorneys substantial fees while providing little or no benefit to individual class members.

2. The Fourteenth Amendment Requires State Courts Of Appeal To Not Act As Trial Courts By Deciding Facts Properly Decided By The Trial Court On Remand

The State Court of Appeals was confronted with a dilemma in this case as the plaintiff had not provided the Trial Court any estimate of the potential recovery from a successful trial. Federal Circuit courts require such estimates to determine the risk adjusted value of the case that is needed to assess the settlement's fairness.

Rather than remand the case for a determination of the risk adjusted value resulting from a successful trial; the Court of Appeals determined that the plaintiff's claims had a zero probability of success based on what the court described as an "admission" by plaintiff's counsel.[9] (App. A, A13)

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[9] The so called "admission" was contained in an introductory summary of the case at the Settlement Hearing by plaintiff's settlement counsel,

Cont.

Consequently, the risk adjusted value of the case was zero making any positive settlement fair to the class.

It is well established appellate jurisprudence that factual determinations – such as the probability that the litigation would be successful – are the responsibility of the trial court judge, who is more familiar with the evidence in the case. Rather than remand the case with appropriate instructions, however, the Court of Appeals avoided further trial court analysis by construing a misleadingly incomplete statement by plaintiff's settlement counsel into a finding of fact that the probability of litigation success is zero.

In making its own finding, the Court of Appeals acted as a trial court and exceeded its appellate jurisdiction. (See *Peck v. Tanner*, 181 S. W. 3d 262, 266 (Tenn. 2005)) (The meaning of the statute is plain – the intermediate court's jurisdiction is 'appellate only.' (Citing Tennessee Code Annotated section 16-4-108(a) (1) (1994)) (Also see *Knox County v. Burroughs*, 369 S.W. 2d 734, 736 (Tenn. 1963). (This Court would prefer to now decide the questions which we recognize may again be before us after a final adjudication, but we cannot, for the sake of expediency, take a jurisdiction not conferred on us.)

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who had not previously participated in the litigation. Counsel prefaced the "admission" with a disclaimer that the oral summary was based on "extensive papers... setting forth for the court the legal theories supporting our view that the settlement is fair." (Tr. 4:1-4) These papers – plaintiff's counsel's Memorandum, and Affidavit on the settlement – show the oral statement relied on by the Court of Appeals was misleadingly incomplete.

Plaintiff's counsel Robbins later acknowledged that settlement counsel was not that familiar with the case. "I'm Darren Robbins, if I may respond. Having been here several times throughout the process. I can refer to some of the factual specifics that Ms. Bull may not be familiar with." (Tr. 17:2-5)

By making the factual findings critical to its opinion, the Court of Appeals exceeds its jurisdiction, short circuits the legal process, and denies parties their rights of appeal. If the issues on the potential recovery from a successful trial and the likelihood a successful trial were remanded to the Trial Court; the losing party would have an automatic right of appeal. By making this assessment themselves, the Court of Appeals denied class members the right to appeal an adverse factual finding. This violates class members Fourteenth Amendment rights to due process and equal protection.

Granting this petition will permit this Court to determine whether due process and equal protection provided by the Fourteenth Amendment protects class members from State appellate courts exceeding their statutory authority in acting as a trial court in making factual findings determinative of the appeal.

3. The Fourteenth Amendment Requires State Courts Of Appeal To Follow Their State's Supreme Court Opinions

In this case, the Court of Appeals disregarded Tennessee Supreme Court opinions by a) not considering Federal authority in affirming the settlement, and b) not relinquishing jurisdiction to the Trial Court to investigate of allegations of corruption.

a. Disregarding Federal Authority

The Tennessee Supreme Court considers the opinions of Federal courts "persuasive" when the legal issues confronting both courts are identical.

> In the context of the issue here, Tenn. Rs. Civ. P. 23 and 54.02 are identical in all respects to Fed. Rs. Civ. P. 23 and 54(b). Therefore, the opinions of the

federal courts are persuasive authority in this area.

Bayberry Associates v. Jones, 783 S.W. 2d 553, 557 (Tenn. 1990)

The Tennessee Supreme Court affirmed the persuasiveness of federal authority in Tennessee class actions in *Meighan v. U.S. Sprint Communications* 924, S.W. 2d 632, 637 (Tenn. 1996). That case involved Rule 23.10, 23.02, and 23.02(3) Tenn. Rs. Civ. P., which concern the initial and continued certification of a class and grounds for decertifying a class.

The issue in this case reflects the settlement of class action pursuant to Rule 23.05 of the Tenn. Rs. Civ. P. that is identical to the pertinent part of federal rule as seen in Appendix D at A24.

Federal Circuit Courts have long required district courts to evaluate the "likelihood for success" and "the range of possible recovery" from a trial in order to evaluate the fairness of a class action settlement. See discussion at 14. In this case, the Trial Court did not quantify the likelihood for success nor did the plaintiff provide the court estimates of a range of recovery from a successful trial. Without an analysis of these factors, it is impossible to evaluate the fairness of any settlement.

The Court of Appeals determined that its "decisions are not controlled by the opinions of the other courts of the federal system." (App. A, A11) (Citing *Bowman v. Henard*, 547 S.W. 2d 527, 530 (Tenn. 1977)) The Court of Appeals opinion did not mention the later Tennessee Supreme Court opinions, *Bayberry* and *Meighan*, that held that Tennessee courts should consider federal authority "persuasive" in matters of Rule 23 Jurisprudence where the Tennessee rules

and Federal rules are virtually identical.

Notwithstanding these Tennessee Supreme Court opinions, the Court of Appeals was "not persuaded that an estimate of potential recovery in the event of successful litigation was required as a prerequisite to an approval of the settlement under the circumstances in this case, especially in light of the following admission by Denver's attorney at the fairness hearing:" (App. A, A12) In the court's view, plaintiff's counsel had admitted "that the litigation would not be successful" and remanding the case to the Trial Court "would have only resulted in unnecessary cost and further delay." (App. A, A13) In making these findings, however, the Court of Appeals is exceeding its jurisdiction by acting as a trial court. (See discussion at 20.)

b. Not Relinquishing Jurisdiction

The Court of Appeals later disregarded the Tennessee Supreme Court's procedure in not granting the appellant leave to file a Rule 60 motion where allegations of corruption or improprieties arise with respect to a trial court decision while the appellate court has jurisdiction. The Supreme Court found:

> 'that because the trial court will most likely be in a better position to quickly assess the merits of such a motion, leave should be freely granted by the appellate court if the motion is not frivolous on its face.'
>
> *Peck v. Tanner*, 181 S.W. 3d. 262, 267 (Tenn. 2005) (Quoting *Spence v. Allstate Ins. Co.* 883 S.W. 2d 586, 596 (Tenn. 1994))

The corruption in this case arises from the indictment of

the law firm that filed the Clayton class action for paying kickbacks to representative plaintiffs in over 150 securities class action law suits by the United States Attorney in Los Angeles. In addition, a subsequent follow up investigation of four recent class action settlements in Illinois by the *Chicago Tribune* determined that this firm had made suspicious payments to the union pension fund representative plaintiffs in these cases as well.[10]

Courts with active cases where the indicted firm was representing plaintiffs began their own investigations. The U.S. District Court (District of Minnesota) justified its sua sponte inquiry on its "heavy burden" to protect the transferee plaintiffs; citing *In re Wireless Telephone Federal Cost Recovery Fees Litigation*, 396 F. 3d 922, 932 (8th Cir. 2005) ("the district court acts as a fiduciary, serving as a guardian of the rights of the ... class members); *Pigford v. Johanns*, 416 F. 3d 12, 25 (D.C. Cir. 2005) (the court has a duty to protect class members); *Stewart v. General Motors*, 756 F. 2d 1285, 1293 (7th Cir. 1985) (same).[11]

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[10] The Tribune quoted U.S. District Judge James S. Gwin who presided over the FirstEnergy case: "[i]t was never brought to my attention that this relationship existed. And that would have been important to me when I made the decision on who was going to be lead plaintiff and lead counsel, and when I was deciding on their application for attorneys' fees."

David Kidwell, Illinois lawyer tied to indicted law firm, Chicago Tribune, June 22, 2006, p. 4.

[11] After considering written submissions, Judge Rosenbaum relieved counsel of their duties to the transferee plaintiffs. In a footnote, the court stated that it "consider[ed] any possible distinction which might be drawn between the Court's duty to protect class action plaintiffs and those in [a] MDL case to be trivial."

Order, In re Medtronic, Inc., Implantable Defibrillator Product Liability Litigation, Case 0:05-md-01726-JMR-AJB (D. Minn., June 5, 2006)

The Tennessee Supreme Court held that when allegations of corruption arise when the Court of Appeals has jurisdiction that 'leave should be freely granted by the appellate court if the [Rule 60] motion is not frivolous on its face.' *Peck v. Tanner*, 181 S.W. 3d. 262, 267 (Tenn. 2005) citing *Spence v. Allstate Ins. Co.*, 883 S.W. 2d 586, 596 (Tenn. 1994)

Yet the Court of Appeals denied the Hayes motion to remand the case to the trial court, disregarding both Tennessee Supreme Court authority and U.S. District Court precedent. When confronted by the same allegations of corruption, the District Court determined "that [the court's] duty requires the [c]ourt to question..." (*Medtronic Order* at 6) Considering the court's duty to protect class members, petitioner's motion to remand the case to the Trial Court could hardly be viewed as frivolous.

Granting this petition will permit this Court to determine whether due process and equal protection provided by the Fourteenth Amendment protect class members from expedient State appellate courts that disregard their State Supreme Court opinions by a) not considering Federal authority in affirming settlements, and b) not relinquishing jurisdiction to the trial court to investigate allegations of corruption.

4. The Fourteenth Amendment Requires State Courts of Appeal To Follow Their Own Precedent

Seventeen months prior to its opinion in this case, this same Court of Appeals considered another class action settlement. The Court of Appeals remanded that case to the trial court for an additional fairness hearing to ensure that "all evidence pertinent to the fairness and validity of [that] settlement be heard." *Posey et al. v. Dryvit Systems et al.*, No E2004-02013-COA-R9-CV (Tenn. Ct. App. 2005) at p.3.

In *Posey*, the Court of Appeals sought to protect the rights of homebuilders who sought to intervene in a class action settlement regarding defective home siding. The Court of Appeals based its *Posey* opinion on the same Federal Circuit opinions it eschews in this case. Thus, the court held that the "Trial Court must exercise 'the highest degree of vigilance in scrutinizing proposed settlements' and acts as a type of fiduciary for the class members." (Quoting *Reynolds v. Beneficial National Bank*, 288 F. 3d 277, 279 (7th Cir. 2002)) The court further recognized that Federal Circuit Courts:

> have required the trial court to take extra care when determining if the settlement is fair, considering all the factors as the '**risk and likely return to the class of continued litigation,' the range of possible outcomes and probability of each**,...
>
> *Posey* at 3. (quoting *Beneficial* at 280) (**Emphasis added.**)

The Court of Appeals does not explain how it justifies a remand in *Posey* directing a *Beneficial* economic analysis but denies a remand in this case that similarly lacks a *Beneficial* analysis. Disregarding its *Posey* opinion, the court's explanation is that it can make the economic analysis and simply avoid the "unnecessary cost and further delay in this already protracted case." (App. A, A13) (The problem with this approach is described at 19.)

The petitioner submits that the court's rational in this case would have more justification than in *Posey*. In that case, class counsel noted that no class members with homes built by the intervening builders had filed claims and in addition "had not brought claims against the Intervenors and are not likely to do so." (*Posey* at 2.)

Nevertheless in *Posey*, the Court of Appeals reviewed the transcript of the fairness hearing concluding "that the Trial Court's scrutiny of the settlement was cursory at best [and directed] an additional fairness hearing..." (*Posey* at 3.) In this case, this same Court of Appeals could have hardly reached a different conclusion as the transcript shows the Trial Court didn't ask a single probative question during the entire fairness hearing. Thus, when the Court of Appeals needed the Trial Court's assessment of the probability that the litigation would be successful it was reduced to finding an "admission" in the introductory remarks of plaintiff's settlement counsel who had no first hand knowledge of the litigation.

In contrast to its vigilance in *Posey*, this same Court of Appeals can find no reason to remand the Clayton class action to the Trial Court even considering the fact that counsel initiating this class action has been indicted for paying kick-backs to its lead plaintiffs in a investigation that is continuing as discussed at 23.

Granting this petition will permit this Court to determine whether due process and equal protection provided by the Fourteenth Amendment protect class members from adverse State appellate courts opinions that ignore their own precedent.

C. Granting This Petition And Finding That The Fourteenth Amendment Applies To State Class Actions Is A Necessary Link Applying The Federal Constitution To Going Private Transactions Under The Aegis Of State Merger Law

Finally, there is a wider more important aspect of Fourteenth Amendment jurisprudence that would benefit

from granting this petition. This relates to the basic unfairness that confronts shareholders in management and insider led buyouts. State merger laws advantage these and other mergers by permitting a simple majority vote (or any other majority determined by the State) to break the shareholder contract, eliminating the acquired corporation as a legal entity.

Buyouts extinguish shareholders ownership rights with the States providing limited opportunity for shareholders in the acquired corporation receive a fair price based on an independent an appraisal.[12]

Management led going private transactions infuse these going private transactions with fiduciary duty and conflict of interest problems that make it likely that shareholders will not receive fair compensation for their ownership of the acquired corporation. Ben Stein noted that the founder of Metromedia, for example, bought out his public shareholders for about $43.50 per share and then sold off the pieces of the

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[12] A corporation forms a three-way contract among a State, a corporation, and its shareholders. That contract is subject to protection of Article 1 section 10 of the United States Constitution, which prohibits States from the impairment of contracts. No dissolution, consolidation, or other fundamental change may be made in the charter without unanimous consent of all shareholders. *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819)

There is some controversy on whether the Contracts Clause applies to the modern corporation. Some legal scholars argue that the framers intended that the Contracts Clause only apply to contracts existing prior to the Constitution. Under the Reserve Clause, States are provided the power over corporate affairs which would mean little if unanimous consent were required to effect fundamental changes in the corporate charter. Today there is general agreement that States can allow fundamental corporate change with a simple majority vote, for example, provided there are provisions for shareholders to receive just compensation.

company for about eight times as much.[13] (App. E, A25)

Stein argues that all insider and management led buyouts should be unlawful based on basic fiduciary duty and conflict of interest law. Stein's argument, however, ignores the economic benefits of the corporate restructuring that these buyouts facilitate by making companies leaner and more profitable. These buyouts also benefit shareholders by offering a premium to the trading value of the stock.

Shareholders do not want courts to rule these buyouts unlawful as argued by Stein but rather the protection of the Due Process and Equal Protection Clauses that would provide State court review of the fairness of the merger price similar to that provided by Delaware's entire fairness doctrine in mergers involving a dominant shareholder.[14] The possibility that Fourteenth Amendment could extend judicial fair price assessments to all management and insider led going private transactions is another reason for granting the petition.

Granting this petition could allow shareholders disadvantaged by directors' breach of fiduciary duty or a misleading proxy statement to receive a fair price for their stock. As a result, the efficiency of the public markets should improve, increasing national wealth.

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[13] Ben Stein, *On Buyouts, There Ought to Be a Law*, NY Times, Sept. 3, 2006 Bu p. 3.

[14] *Kahn v. Lynch Communications Systems Inc.*, 638 A. 2d 1110 (Del. 1994)

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

January 27, 2007

Respectfully submitted,

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Appendix A: Court of Appeals Opinion

IN THE COURT OF APPEALS OF TENNESSEE
AT KNOXVILLE
April 6, 2006 Session

DENVER AREA MEAT CUTTERS AND EMPLOYERS PENSION PLAN, ET AL. v. JAMES L. CLAYTON, ET AL.

Appeal from the Chancery Court for Blount County
No. E-19723 W. Dale Young, Chancellor

No. E2005-01557-COA-R3-CV

In this appeal, Mr. Hayes, a shareholder of Clayton Homes, Inc., argues that the trial court erred in approving the settlement of a shareholder class action complaint filed by Denver Area Meat Cutters and Employers Pension Plan, *et al.*, also a shareholder of Clayton Homes, Inc., against members of Clayton's board of directors on behalf of Clayton's shareholders. The complaint charged the directors with breach of fiduciary duties in connection with the acquisition of Clayton by Berkshire Hathaway, Inc. and in connection with an associated merger of Clayton and a Berkshire subsidiary. Mr. Hayes contends that the trial court erred in approving the settlement because the trial court did not consider the potential recovery of damages had the case proceeded to trial, because the settlement resulted in a great disparity between the per share recovery of Clayton shareholders and the award of attorney's fees to Denver's counsel, and because the complaint filed by Denver did not include proxy fraud claims or assert Delaware's entire fairness doctrine. We affirm the judgment of the trial court and remand.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed; Cause Remanded

SHARON G. LEE, J., delivered the opinion of the court, in which CHARLES D. SUSANO, JR., and D. MICHAEL SWINEY, JJ., joined.

James J. Hayes, Annandale, Virginia, appellant, appearing *pro se*.

John T. Winemiller and John A. Lucas, Knoxville, Tennessee, for the appellees Clayton Homes, Inc., and James L. Clayton, Kevin T. Clayton, C. Warren Neel, B. Joe Clayton, Steven G. Davis, Dan W. Evins, Wilma H. Jordan, and Thomas N. McAdams.

Kevin K. Green, San Diego, California, and Douglas S. Johnston, Jr., and James G. Stranch, III, Nashville, Tennessee, for the appellee Denver Area Meat Cutters and Employers Pension Plan.

OPINION

1. Background

In April of 2003, Clayton Homes, Inc. ("Clayton"), a publicly-owned Delaware corporation headquartered in Maryville, Tennessee, disclosed that it had agreed to merge with B Merger Sub, Inc., a subsidiary of Berkshire Hathaway, Inc. ("Berkshire"), another publicly-owned Delaware corporation. Clayton would be the surviving corporation of the merger under the name of Clayton Homes, Inc.

On or around June 16,2003, Clayton advised each of its shareholders of the merger by a mailing which included a proxy statement and copy of the merger agreement. Also included in this correspondence was notice that a special stockholders' meeting would be held on July 16,2003, for the purpose of voting on the merger. The merger agreement provided that,

upon completion of the merger, Clayton stockholders would be allowed $12.50 per share for Clayton common stock owned. *Inter alia*, the letter stated that Clayton's board of directors recommended approval of the merger and had determined that the terms of the merger were fair to Clayton's stockholders.

The stockholder meeting to vote on the merger was convened on July 16,2003; however, prior to a formal vote being taken, the meeting was adjourned to July 30, 2003. When the meeting reconvened on July 30, 2003, shareholders voted to approve the merger pursuant to the terms of the merger agreement by an affirmative vote of a majority of all outstanding shares of Clayton common stock.

On July 25, 2003, and by amendment of July 30, 2003, Denver Area Meat Cutters and Employers Pension Plan ("Denver") filed a complaint in the Circuit Court for Blount County alleging both class action claims and shareholder derivative claims on behalf of Clayton against Clayton Homes, Inc. and the pre-merger members of Clayton's board of directors. Among other things, Denver's lawsuit charged that the merger terms were unfair and that, in approving such terms, the directors had breached their fiduciary duties. The complaint requested class certification, damages for breach of fiduciary duty, and an injunction against consummation of the merger.

On August 4, 2003, Denver moved for a temporary restraining order to enjoin approval of the merger pending review of the July 30, 2003, vote to approve the merger. This motion was denied, and on August 7,2003, the merger was consummated by the filing of a certificate of merger with the Delaware Secretary of State. On that same date, shortly after the certificate of merger was filed, Denver filed an application for extraordinary appeal pursuant to Tenn. R. App. P. 10, and requested that this Court grant its motion of August 4, 2003, and enjoin approval of the merger.

We granted Denver's application for extraordinary appeal, and on August 7, 2003, Denver, referencing the allegation of fraud in its complaint, argued that the merger had not occurred under an applicable Delaware statute which provided that endorsement upon the certificate of merger by the Secretary of State of the time and date of filing would be conclusive of the time and date of filing "in the absence of actual fraud." After considering the parties' arguments, we remanded for, among other things, a development of the record as to the meaning of this statutory language and as to whether Denver had standing to maintain its derivative action in light of the status of the merger. In addition, we instructed the trial court, should it find that Denver retained standing, to reconsider Denver's motion for a temporary restraining order. We further instructed the trial court to reconsider Denver's motion for a temporary restraining order as applicable to Denver's class action claim, even should the court determine that Denver was without standing to pursue its derivative action.

Upon remand, the trial court concluded that Denver had made a *prima facie* showing of fraud and, consequently, Denver's shareholder derivative suit and class action suit should proceed and a motion by the defendants to stay these suits should be denied. The trial court further restrained the defendants "from any action to change the status quo of the subject merger" pending further court orders. In response, the defendants filed an application for extraordinary appeal.

We granted the defendants' application for extraordinary appeal, and addressed the following issues: I) whether the merger had occurred and, if so, whether it deprived Denver of standing to pursue a stockholders' derivative action; 2) whether Denver was entitled to a temporary injunction to prevent, in the terminology of the trial court, "any action to change the status quo of the subject merger"; and 3) whether Denver's class action claims should be stayed in deference to other class action claims

regarding the merger that were then pending in Delaware.

As set forth in *Denver Area Meat Cutters and Employers Pension Plan v. Clayton*, 120 S.W.3d 841 (Tenn. Ct. App. 2003), we concluded that the merger was effective at 7:29 a.m. on August 7, 2003, and that, at that time, Denver lost standing to further pursue its later filed stockholders' derivative suit. We also found that the trial court's status quo injunction constituted, in effect, a temporary injunction. We found no legal authority to support Denver's argument that its allegations of fiduciary fraud were legally sufficient to invalidate the merger. We also noted the test for issuance of a preliminary injunction, as set forth in *S. Cent. Tenn. R.R. Authority v. Harakas*, 44 S.W.3d 912, 919 (Tenn. 2000), which includes as one factor "the probability that plaintiff will succeed on the merits," and we stated that "the facts before us do not show that there is a probability that the plaintiff will be successful at trial in its efforts to undo the merger." *Denver Area Meat Cutters*, 120 S.W.3d at 859. Based upon our findings, we vacated the trial court's action to change the status quo of the merger. We further vacated the trial court's denial of the defendants' motion to stay Denver's stockholders' derivative claims; however, we affirmed the trial court's denial of such motion as to Denver's class action claims and directed that suit as to these latter claims "progress in an orderly manner consistent with the nature of this class action." The case was then remanded for proceedings consistent with our opinion.

Following remand, the defendants filed a motion to dismiss, and Denver filed a motion to amend its complaint. Thereafter, on March 18, 2005, the trial court preliminarily approved settlement of the case. Pursuant to the terms of this settlement, the defendants agreed that, in exchange for release of claims by the settlement class,[1] it would pay the settlement class five million

[1]The settlement defines "settlement class" as "all persons who held

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dollars and additional monies contingent upon the sale of Clayton Homes, Inc. by Berkshire Hathaway before December 31, 2005.[2] In addition to approving the settlement, the trial court certified the settlement class, approved the manner and form of the notice of the settlement, and' directed that the notice be mailed to all members of the settlement class by first class mail and published in *Investor's Business Daily*. Finally, the court set a hearing for May 16, 2005,[2] "to determine whether the proposed settlement of the Litigation on the terms and conditions provided for in the Stipulation [of settlement] is fair, reasonable and adequate to the Settlement Class and should be approved by the Court... ."

The declaration of an employee of the firm retained as claims administrator in the case confirms that 94,713 notices of the settlement were mailed to potential class members. Six notice recipients, including appellant James J. Hayes, objected to the settlement.

At the scheduled hearing on final approval of the settlement, the trial court heard arguments of attorneys for Denver and attorneys for the defendants, as well as the arguments of Mr. Hayes and two other individuals who had objected to the settlement. The trial court also considered the written objections of the three absent objectors. Thereafter, on June 7, 2005, the trial court entered final judgment approving the stipulation of settlement. *Inter alia*, the judgment provides as follows:

> This Court has considered the nature of the claims, the possible defenses to the claims, the legal and factual obstacles that would be faced

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shares of Clayton Homes common stock on April 2, 2003 (date of announcement of Acquisition) **and** continued to hold those same shares until August 7, 2003 (date of close of Acquisition.)" (Emphasis in original).

[2]Such sale did not transpire.

by the Plaintiff at trial, and the delay, expense and complexity of the litigation. *See Cox v. Shell Oil Co.*, Civ. A. No. 18844, 1995 WL 775363, at *10 (Tenn. Ch. Nov. 17, 1995). Plaintiff asserted that Defendants breached their fiduciary duties to the Settlement Class in connection with the Acquisition of Clayton Homes by Berkshire Hathaway. Defendants vehemently deny any wrongdoing. Plaintiff faced substantial legal and factual obstacles to going forward, including the opinion issued by the Court of Appeals of Tennessee, at Knoxville, on September 3,2003. The Appellate Court held: "We find no legal authority to support the plaintiff's position that its allegations of breach of fiduciary duty/fraud in this case are legally sufficient to invalidate a merger that has occurred and will shortly be fully consummated." *Denver Area Meat Cutters and Employers Pension Plan v. Clayton*, 120 S.W.3d 841, 856 (Tenn. Ct. App. 2003). Further, the Appellate Court found that "there is not a scintilla of evidence in this record demonstrating that a single vote was incorrectly counted or that any share of stock was voted in favor of the merger because of any alleged fraudulent act of the defendants." *Id.* at 859. Moreover, continuation of this complex case, in light of the vigorous litigation by both sides, would require significant expenses and unduly delay any ultimate recovery for the Settlement Class.

Based upon the foregoing, together with a review of the entire record in this case, and pursuant to Rule 23 of the Tennessee Rules of Civil Procedure, this Court hereby grants Plaintiff's Motion and expressly approves the settlement set forth in the Stipulation. The Court finds that

said settlement is, in all respects, fair, reasonable and adequate to, and is in the best interests of, the Plaintiff, the Settlement Class and each of the Settlement Class Members. *See Williams v. Vukovich*, 720 F.2d 909, 921 (6th Cir. 1983); *Officers for Justice v. Civil Servo Comm 'n*, 688 F.2d 615 (9th Cir. 1982). The Court further finds that the settlement set forth in said Stipulation is fair in view of the risks of continued litigation under the circumstances of this case, especially in light of the risk of success on the merits following the Appellate Court's ruling filed on September 3,2003. This Court further finds the settlement set forth in the Stipulation is the result of arm's-length negotiations between experienced counsel representing the interests of the Plaintiff, the Settlement Class Members and the Defendants. The Court further finds that the settlement provides substantial value to the Settlement Class. *See Mills V. Elec. Auto-Lite Co.*, 396 U.S. 375,395-96 (1970). Accordingly, the Court finds it proper that the aforesaid settlement embodied in the Stipulation be approved in all respects and it is the Order of the Court that the Stipulation shall be consummated in accordance with the terms, conditions, and provisions therein contained. The Settling Parties are hereby directed to perform the terms of the Stipulation.

The Court further finds that upon consideration of all objections concerning the fairness, reasonableness or adequacy of the settlement, said objections are without merit and are overruled.

The final judgment further provides as follows for the release

of claims against "Released Persons" which are defined in the settlement as "each and all of the Defendants and their Related Parties":

> Upon the Effective Date, the Plaintiff and each of the Settlement Class Members shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished and discharged all Released Claims against the Released Persons, whether or not such Settlement Class member executes and delivers a Proof of Claim and Release from.

The settlement defines "Released Claims" as "any and all claims, causes of action, demands, rights or liabilities, including both known and unknown claims... ."

II. Issues

Mr. Hayes appeals this judgment and presents for our review three issues which we restate as follows:

1) Did the trial court err in approving the merger without considering the potential recovery of damages had the case proceeded to trial?

2) Should the trial court have denied approval of the settlement because of the disparity between attorney's fees allowed under the settlement and the per share recovery provided to Clayton stockholders?

3) Did the trial court err in approving the settlement where the underlying complaint omitted proxy fraud claims and failed to assert Delaware's entire fairness doctrine?

III. Standard of Review

The parties do not dispute that this Court properly reviews a trial court's approval of a settlement under the abuse of discretion standard. *See Cummings v. Patterson*, 388 S. W .2d 157, 167 (Tenn. Ct. App. 1964). In *Eldridge v. Eldridge*, 42 S.W.3d 82, 85 (Tenn. 2001), the Tennessee Supreme Court stated as follows regarding the abuse of discretion standard:

> Under the abuse of discretion standard, a trial court's ruling "will be upheld so long as reasonable minds can disagree as to the propriety of the decision made." *State v. Scott*, 33 S.W.3d 746, 752 (Tenn. 2000); *State v. Gilliland*, 22 S.W.3d 266,273 (Tenn. 2000). A trial court abuses its discretion only when it "applie[s] an incorrect legal standard, or reache[s] a decision which is against logic or reasoning that cause[s] an injustice to the party complaining." *State v. Shirley*, 6 S.W.3d 243, 247 (Tenn. 1999). The abuse of discretion standard does not permit the appellate court to substitute its judgment for that of the trial court. *Myint v. Allstate Ins. Co.*, 970 S.W.2d 920, 927 (Tenn. 1998).

An abuse of discretion occurs when the lower court's decision is without a basis in law or fact and is, therefore, arbitrary, illogical or unconscionable. *State v. Brown & Williamson Tobacco Corp.*, 18 S.W.3d 186, 191 (Tenn. 2000).

In reviewing this case, we also bear in mind, as we recently reiterated, that" 'settlement agreements ... are favored by the courts and represent the achievement of an amicable result to pending litigation.'" *Petersen v. Genesis Learning Centers*, No. M2004-01503-COA-R3-CV, 2005 WL 3416303 (Tenn. Ct. App. M.S., Dec. 13,2005) (citing *In re Estate of Jones*, 154 S.W.3d 582, 584 (Tenn. Ct. App. 2004).

IV. Potential Recovery

The first issue we address is whether the trial court erred in approving the settlement without considering the potential recovery in damages had the case proceeded to trial.

Mr. Hayes argues that "[b]efore a class member or a court can assess the fairness of a particular settlement[,] there must be an estimate of the potential recovery if the case did not settle but proceeded to trial." He asserts that "[c]ourts have no choice but to reject settlements where there is no basis for an evaluation [for fairness]." Mr. Hayes contends that "[j]ust as it is impossible mathematically to solve a single equation with two unknowns[,] it is analytically impossible to assess the fairness of the settlement without good knowledge of the 'potential recovery' from a successful trial." Mr. Hayes cites federal case law in support of this argument. He also references the Private Securities Litigation Reform Act ("PSLRA"), codified at 15 U.S.C.§P8u-4, which he asserts "requires a disclosure of settlement terms to class members that includes a statement on the potential outcome of [the] case." Mr. Hayes maintains that "[i]n a Federal securities case, the Clayton Settlement Notice would violate the PSLRA."

Although our decisions are controlled by the United States Supreme Court when that Court has held that a particular course of conduct violates the federal constitution, our decisions are not controlled by the opinions of the other courts of the federal system. *Bowman v. Henard*, 547 S. W.2d 527, 530 (Tenn. 1977). Mr. Hayes does not assert that the federal constitution was violated in this case and cites no United States Supreme Court cases in that regard and, while we may, in our discretion, follow the opinions of other federal courts, we are not bound to do so. Furthermore, Mr. Hayes' reference to the PSLRA is inapposite. It is irrelevant whether the Clayton settlement notice would have violated the PSLRA if this had been a federal securities case,

in light of the fact that this is *not* a federal securities case. Mr. Hayes presents no Tennessee authority in support of his argument that the trial court was without discretion to approve a settlement absent evidence of potential recovery at litigation.

Even under federal case law, it is acknowledged that a great disparity between the settlement amount and the amount of potential recovery in a class action suit will not determine the fairness of a proposed settlement.

> The dollar amount of the settlement by itself is not decisive in the fairness determination. The fact that the settlement amount may equal but a fraction of potential recovery does not render the settlement inadequate. Dollar amounts are judged not in comparison with the possible recovery in the best of all possible worlds, but rather in light of the strengths and weaknesses of plaintiffs' case.

In re Agent Orange Product Liability Litigation, 597 F. Supp. 740, 762 (E.D. N.Y. 1984). The court in that case further noted that "[t]he most important consideration [in determining whether a settlement is fair] is the strength of plaintiffs' case on the merits weighed against the amount offered in settlement." Id. *See also Cohn v. Nelson*, 375 F. Supp.2d 844,853 (E.D. Mo. 2005) and *In re Wireless Tel. Fed. Cost Recovery Fees Litig.*, 396 F.3d 922, 932 (8th Cir. 2005).

We are not persuaded that an estimate of potential recovery in the event of successful litigation was required as a prerequisite to an approval of settlement under the circumstances in this case, especially in light of the following admission by Denver's attorney at the fairness hearing:

> [D]espite what I think were fairly valiant

> efforts on the part of the plaintiffs' lawyers, the Court of Appeals finally, in their ruling, disagreed with our view of the evidence and basically substantially eliminated the merits of our case, in our view, had we tried to go forward to trial. Under those circumstances, we were able to obtain not zero for the class, but $5 million for the shareholders and the potential that if the Clayton stock or a substantial portion of the assets are sold before the end of this year, the shareholders will also get some benefit from that.

We do not agree that there would have been any advantage in requiring Denver to produce a statement of potential recovery in the event of successful litigation when Denver stated, in essence, that the merits of its case had been eliminated, that litigation would not be successful, and that nothing would be recovered if the case proceeded to litigation. Given this admission, we cannot imagine how an estimate of potential recovery in the event of successful litigation would have affected the trial court's decision in any way whatsoever, and requiring such would have only resulted in unnecessary cost and further delay in this already protracted case.

V. Disparity Between Attorney's Fees and Per Share Recovery

The next issue we address is whether the trial court abused its discretion in approving the settlement despite the disparity between the attorney's fee allowed Denver's counsel and the amount of per share recovery to Clayton shareholders under the settlement.

Mr. Hayes asserts that the settlement results in a net amount to shareholders of $0.067 per share after payment of attorney's

fees in the amount of $1.67 million dollars. He states that this Court must determine "whether a settlement that provides both: 1) a low per share payment and 2) guarantees high attorney fees is per se an abusive settlement that should be routinely rejected."

Section 5.2(a) of the settlement states that the settlement fund shall be applied in part "to pay Plaintiff's Counsel's attorney's fees and expenses with interest thereon (the "Fee and Expense A ward"), *if and to the extent allowed by the Court.*" (Emphasis added). At Section 6 the settlement further provides in pertinent part as follows:

> 6.1 Plaintiff's Counsel may submit an application (the "Fee and Expense Application") for distributions to them from the Settlement Fund for: (a) an award of attorneys' fees; plus (b) reimbursement of expenses incurred in prosecuting the Litigation, plus interest on such attorneys' fees and expenses at the same rate and for the same periods as earned by the Settlement Fund (until paid).
>
> 6.2 The attorneys' fees and expenses, as awarded by the Court pursuant to the application by Plaintiff s Counsel described in ')[6.1 above, shall be paid to Plaintiffs Settlement Counsel from the Settlement Fund, as ordered, immediately after the Court executes an order awarding such fees and expenses. Plaintiff's Settlement Counsel shall thereafter allocate the attorneys' fees in a manner which reflects the contributions of Plaintiff's Counsel to the prosecution and settlement of the Litigation.
>
> •••

> 6.4 *The allowance or disallowance by the Court of any award of attorneys' fees and/or expenses is not part of this settlement, and will be considered by the Court following approval of this Stipulation and separately from the Court's consideration of the fairness, reasonableness and adequacy of the settlement.* Any order or proceeding relating to the application by Plaintiff's Counsel for an award of attorneys' fees and expenses, or any appeal from any order relating thereto or reversal or modification thereof, shall not operate to terminate or cancel this Stipulation, or affect or delay the finality of the Judgment approving this Stipulation and the settlement of the Litigation set forth herein.

We further note that the trial court's final judgment approving the settlement states that "any order entered regarding the attorneys' fee and expense application shall in no way disturb or affect this judgment and shall be considered separate from this Judgment."

Attorney's fees were awarded in the amount of one-third of the settlement fund by separate order entered June 8, 2005, which states, *inter alia*, as follows:

> The Court concludes that the percentage of the benefit is the proper method for awarding attorneys' fees in this case. *See Blum v. Stenson*, 465 U.S. 886, 900 n.16 (1984). Having reviewed and considered the relevant legal authority, including the factors normally considered in awarding fees in common fund cases, and Plaintiff's Counsel's fee application, the Court concludes that one-third is a reasonable percent-

> age. The Court finds that Plaintiff's Counsel competently and vigorously represented the Settlement Class, carried the financial burden of litigating the case with the substantial risk of no fee payment, expended considerable time and labor in prosecuting the complex issues raised in this case, and obtained a fair recovery despite the procedural posture of the case. The Court also notes that a one-third fee is consistent with the market rate in other complex contingent cases.

Given the segregation of the award of attorney's fees from the settlement, as evidenced by the referenced language, we cannot agree with Mr. Hayes' statement that the settlement guarantees "high" attorney's fees. In any event, we find Mr. Hayes' assertions that the per share payments were "low" and the allowed attorney's fees in this case were "high" to be subjective and conclusory, and not supported by reference to evidence in the record. Unquestionably, there is a great disparity between the per share recovery under the settlement and the amount awarded in attorney's fees; however, this fact does not of itself indicate that the settlement was "abusive" "and should not have been approved, and Mr. Hayes cites no law holding to the contrary. We believe the appropriate point of inquiry is not the degree of disparity between these amounts, but rather whether each particular amount was unreasonable under the circumstances. Our examination of the record before us does not reveal that either of these amounts was unreasonable under the circumstances of this case, and we do not find that the trial court abused its discretion in approving either the settlement or the award of attorney's fees.

VI. Proxy Fraud Claims and Entire Fairness Doctrine

The final issue raised in this appeal is whether the trial court

erred in approving the settlement of Denver's complaint even though the complaint failed to raise proxy fraud claims against Clayton's directors and failed to assert Delaware's fairness doctrine.

Mr. Hayes references the settlement's release of the defendants "from known and unknown violations of any state or federal statutes, rules or regulations that could have been asserted in any other forum based on or related in any way to the Acquisition." Mr. Hayes first contends as follows that the trial court erred in approving the settlement because it released proxy claims against the defendants that Denver should have included in its complaint:

> In the complaint, the Plaintiff alleged that Clayton's directors conspired "to enter into the Merger Agreement with Berkshire Hathaway at an inadequate price and to enter into the stockholder agreement, ... in an attempt to obtain control of the votes required to gain approval of the Proposed Acquisition." If the directors had their doubts about the adequacy of the $12.50 per share price in March 2003, then their statements of opinion on the fairness of that price in the proxy soliciting shareholder votes for the July 15 shareholder vote would have been false and misleading. In addition, the increasing stock prices of manufactured housing stocks would have only increased these doubts, thus making the proxy statements even more misleading and making the proxy claim superior to Plaintiff's breach of fiduciary duty claims. Plaintiff's omission of proxy fraud claims appear[s] designed to avoid federal jurisdiction and the early class certification requirements of the PSLRA. In any event, the trial court breached its duty to the

> class by approving a settlement that released claims that were inadequately represented by the Plaintiff.

(Citations to record omitted).

Our review of the record shows that, in the proceedings below, Mr. Hayes never argued that Denver improperly failed to include claims for proxy fraud in its complaint or that the trial court should not have approved the settlement for that reason. As we stated in *Hobson v. First State Bank*, 801 S.W.2d 807, 812 (Tenn. Ct. App. 1990)," [a]n issue not raised nor considered in the trial court but raised for the first time on appeal will not be considered by this Court." Accordingly, we find this issue to be waived.

Mr. Hayes next maintains that the trial court failed to adhere to the so called "entire fairness doctrine" and presents the following argument in that regard:

> The complaint also cites director actions that under Delaware law deprived shareholders of a fair merger process. In making these allegations, however, the Plaintiff ignored a more powerful invocation of Delaware's entire fairness doctrine that is not dependant [sic] on director action. In Delaware, mergers with a dominant shareholder standing on both sides of the transaction invoke the entire fairness doctrine that provides a court determined fair price. *Kahn v. Lynch Communications Systems Inc.*, 638 A.2d 1110 (Del. 1994). The appellant raised this issue in his written objection and at the fairness hearing. The trial court did not comment on the issue at the hearing or in its Memorandum and just with the prior issues breached its duty and discretion

in approving the Settlement.

(Footnote and citations to record omitted).

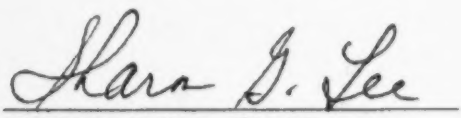
As Mr. Hayes notes, the entire fairness doctrine he seeks to invoke pertains to mergers where there is a dominant shareholder on both sides of the transaction. However, Mr Hayes fails to assert that Berkshire Hathaway was a dominant shareholder standing on both sides of the merger. He does not reference, nor do we find, any evidence that would support that conclusion. Accordingly, we do not agree that Delaware's entire fairness doctrine is applicable in this case.

Finally, in his reply brief, Mr. Hayes also argues that the trial court abused its discretion because, he alleges, it approved the settlement without evaluating claims set forth in Denver's second amended complaint. It does not appear that Mr. Hayes raised this argument in his original brief.

A reply brief allows the appellant to "reply to the brief of the appellee." Tenn. R. App. P. 27. "A reply brief is limited in scope to a rebuttal of the argument advanced in the appellee's brief. An appellant cannot abandon an argument advanced in his brief and advance a new argument to support an issue in the reply brief. Such a practice would be fundamentally unfair as the appellee may not respond to a reply brief." *Caruthers v. State*, 814 S.W.2d 64, 69 (Tenn. Crim. App. 1991). *See also Hobbs v. State*, No. 03COI-9303-CR-007, 1993 WL 539494 n.l (Tenn. Crim. App. Dec. 22,1993); *Gentry v. Gentry*, No. E2000-02714-COA-R3-CV, 2001 WL839714 n.l (Tenn. Ct. App. July 25, 2001) and *Castle v. State*, 2005 WL 2372762, E2005-00874-COA-R3-CV at *4 (Tenn. Ct. App. E.S. Sept. 27, 2005). Mr. Hayes' argument that the trial court improperly failed to review claims advanced in Denver's second amended complaint is advanced for the first time in his reply brief and, therefore, will not be considered.

VII. Conclusion

For the foregoing reasons, the judgment of the trial court is affirmed, and this cause is remanded for whatever further action may be necessary as consistent with our opinion herein. Costs of appeal are assessed to the appellant, James J. Hayes.



SHARON G. LEE, JUDGE

Appendix B: Trial Court Memorandum

This matter came on for hearing on the parties' Stipulation of Settlement heretofore filed of record in this cause on March 18, 2005 and upon Plaintiffs' Notice of Motion and Motion for: (I) Final Approval of Settlement; (2) Approval of Plan of Allocation of Settlement Proceeds; and (3) Award of Attorneys' Fees and Reimbursement of Expenses. Oral argument was had on the Motions on the 16th day of May, 2005 and the matters were taken under advisement.

In addition to considering the arguments regarding the Stipulation of Settlement and the aforesaid Motions, the Court heard the oral arguments of Mr. Jim Hayes, Mr. Leland Wykoff and Mr. Wayne Wykoff on behalf of Mrs. Jo Wykoff.

Prior to the hearing, written objections to the settlement were received and filed by the Clerk from Mr. David L. Porter, Trustee, Mr. Leland Wykoff, Mr. James J. Dorr, Vice President, Orbis Optimal Global Fund, LP, Mr. James J. Hayes and Mr. Vince Struble. The Court is also aware of the objection of Mr. Charles Reinbrecht, Jr., not of record with the Clerk as of May 19, 2005. These objections were considered by the Court.

The parties' Confidential Supplemental Agreement was submitted to and reviewed in camera by the Court.

Based on the foregoing, together with a review of the entire record in this case, the Court hereby grants the Plaintiff's Motions and expressly approves the settlement set forth in the Stipulation of Settlement.

The Court finds said settlement is, in all respects, fair,

reasonable, adequate and is in the best interest of the Plaintiff, the settlement class and each of the settlement class members.

The Court further finds the settlement set forth in the said stipulation is fair in view of the risk of continued litigation under the circumstances of this case.

The Court further finds that upon consideration of all objections concerning the fairness, reasonableness or adequacy of the settlement, said objections are without merit and are overruled.

The Court further finds that upon consideration of all objections concerning payment of attorneys' fees and expenses, said objections are without merit and are overruled.

The Court further finds the settlement set forth in the said Stipulation is the result of arm's-length negotiations between experienced and qualified counsel representing the interests of the Plaintiff, the settlement class members and the Defendants.

The Court finds it proper that the aforesaid Stipulation be approved in all respects and it is the Order of the Court that the Stipulated Settlement be consummated in accordance with the terms, conditions and provisions therein contained.

Mr. Duggan will prepare an appropriate Order, or Orders, pursuant to the provisions of . . this Memorandum, submit same to all Counsel of Record for their approval as to form, and the Order will be tendered to the Court for entry not later than twenty (20) days from the date of this Memorandum.

Appendix C: Supreme Court of Tennessee Order

FILED
OCT 30 2006
Clerk of the Courts
Rec'd by _____

IN THE SUPREME COURT OF TENNESSEE
AT KNOXVILLE

DENVER AREA MEAT CUTTERS v. JAMES L. CLAYTON, ET AL.

Chancery Court for Blount County
No. E-19723

No. E2005-01557-SC-RII-CV

ORDER

Upon consideration of the application for permission to appeal filed on behalf of John J. Hayes [sic] and the record before us, the application is denied.

PER CURIAM

Appendix D: Excerpts From Tennessee Rule 23 and Federal Rule 23

Federal Rule 23. Class Actions

(e) Dismissal or Compromise

A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such a manner as the court directs.

Tennessee Rule 23. Class Actions

23.05 Dismissal or Compromise

A certified class action shall not be voluntarily dismissed or compromised without approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such a manner as the court directs.

Appendix E: *New York Times* Article

On Buyouts, There Ought to Be a Law

(New York Times, Sept. 3, 2006, p. BU3)

Ben Stein

Just as surely as the swallows return to Capistrano, now that the market has corrected a bit, the managers and private equity firms, investment banks and university endowments are out making "going private" deals, or "leveraged buyouts," as they are somewhat misleadingly known.

In a management buyout, or leveraged buyout, managers of public corporations get together with banks or other lenders to buyout the public stockholders and turn the company into a private entity - at least for a time. (The misleading part is that a deal can be highly leveraged, or financed with debt, whether or not management is involved as a buyer. Yet the news media often treats leveraged buyouts as exclusively management-involved deals.)

I became interested in these deals in a big way long ago when I was a small stockholder of Metromedia. I noticed that our founder, John W. Kluge, bought us out for roughly $43.50 a share, then sold off the pieces of the company for about eight times as much, making himself one of the richest men in the nation off profits on assets that had belonged to us public stockholders.

I wrote about it for Barron's and got good response from readers and investors, but Mr. Kluge never bothered to respond.

Soon thereafter, I was a stockholder of a brilliantly managed publicly traded investment firm called Narragansett Capital. Its managers had amassed a treasure trove of cable

television systems and other assets, then proposed to buy it from us stockholders for what seemed to me to be pennies on the dollar.

I begged management to reconsider. They laughed at me - more or less. So I filed many objections with the Securities and Exchange Commission's division of investment management, and thanks to its director, Kathryn McGrath, the commission asked for a full review under the terms of the Investment Company Act. Narragansett Capital's managers opted to drop the deal at that point. In the course of those many filings, I was able to see memos that told me how much management and its investors expected to make on their money, and how much they thought the assets were worth. The profits were going to be breathtaking, and the amounts they were paying us were comical when compared with what the company was worth.

I wrote about many other deals, and helped to stop some of them. The deals were happening because the market swooned in the mid- and late 1980's, but asset values remained high, and so there was a major arbitrage to be realized between asset value and stock price. To me, it seems that this arbitrage belonged to us stockholders and not in any way to our trustees, the managers. But the managers wanted that money, and if they wanted it, they usually got it. There was not much of anyone to stop them.

Then the market rallied and stocks came to be worth more than their underlying assets, so the leveraged buyouts came less often. That gap between the value of the assets that managers sold after the buyout and the stock's value before the buyout had vanished.

Now, the markets have corrected - they have been lackluster for a long time now, in fact - but inflation and immense

gains in the price of oil, as well as gas and other commodities, have spawned opportunities for looting us stockholders, and management buyouts are running riot.

To my mind, these deals should be illegal on their face. That is, they should simply not be allowed at all as a matter of law. Here's why:

The managers do these deals only to make money. It's business, after all. They do them to make money off the assets of the stockholders. They could, if they wished, sell off the assets or otherwise manage them for the good of the stockholders. (Again, the assets of public companies do belong to the stockholders as basic law.) Instead, they buy the assets on the cheap and sell them off for their own management benefit, or they manage the company differently for the benefit of themselves and their buyout partners.

But as a matter of basic fiduciary duty law, managers are bound to put the interests of stockholders ahead of their own, in each and every situation. By buying the assets on the cheap and then reaping the benefits, management is breaching that fiduciary duty, or so it seems to me. Likewise, if the managers can run the company more profitably, they owe it to the stockholders to do that for them.

Then there is the matter of conflict of interest. Management, as a matter of course, is supposed to avoid any conflict of interest with its trustors, the public shareholders, or even the appearance of it. But in a management buyout, management is seeking to pay the least it can get away with for the assets of the public holders, while the public holders want the most they can get.

On its face, this is an irreconcilable conflict of interest, or so it seems to me. (In fact, it's hard to see how managers can

even be allowed to bid at auction for the stockholders' assets against those same stockholders.) Why this kind of conflict is allowed is a mystery to me.

Add to that the problem of a lack of full disclosure. In a management buyout, company managers generally prepare memos for the buyout investors, saying how much they expect to make on the deal. Specifically, they say how much of an internal rate of return they expect on their investment. This, in turn, involves a calculation of just how much more the assets they are buying are worth than what they are paying to us stockholders for those assets.

But those memos are not disclosed to the stockholders or to the market generally. Yet management is required to disclose to us shareholders every material fact in every material transaction. Just how much our assets are worth and how much less than that we are being paid could hardly be more material. But unless there's litigation, these memos are not disclosed. How can this be?

Then there is a little matter of insider trading when insiders (of course) trade stock based on inside knowledge. But what is a management buyout other than trading not just some but all of the shares of the corporation based on inside knowledge of just what the company is worth? How can this be allowed? How tong until a wary court notices? Or Congress? Or the S.E.C.?

NOW, management and its worthy friends say that all is solved because it gets a "fairness letter" from an investment bank saying that the price it is offering for the stock is fair. But this means zilch. Investment banks never cross management any more than appraisers cross lenders. Fairness letters, like appraisals, are usually "M.A. I.." - made as instructed. I have heard horror stories of summer interns

doing these letters for an investment bank - sometimes the same investment bank that has an interest in the deal just as dictated by their bosses.

I want to make sure you know that I am somewhat ahead of the curve. No court has yet put all of this together and banned management buyouts. But it took a long time for courts to bar segregation or for Congress to bar residential housing discrimination. Management buyouts are great for management. But by every standard I can see, they are yet another sad sign of how our corporate trustees have lost their moral compass.

The time for them to stop is long overdue. If the stockholders have hired you and pay your wage to manage their assets, your job is to do that for them - not to buy them out at fire~sale prices and turn around and make billions that rightfully belong to them. The management buyout is a sad and infuriating avatar of a decadent age.

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